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No. 84-1447

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

WILLIAM Z. SALCER, *et al.*,
Petitioners,

vs.

ENVICON EQUITIES CORP., *et al.*,
Respondents.

RESPONDENTS' JOINT BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED FOR REVIEW

In an interlocutory appeal pursuant to 28 U.S.C. §1292(b), did the United States Court of Appeals for the Second Circuit properly reverse, and remand for discovery and further proceedings, the district court's order, pursuant to Rule 12(f) of the Federal Rules of Civil Procedure, striking affirmative defenses which alleged that tax savings obtained by the petitioners as a result of their investment in a tax shelter venture reduce damages recoverable under Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934?

---

* PARTIES

Pursuant to Rule 28.1, the following describes the parent companies, subsidiaries and affiliates of respondents:

Envicon Equities Corp.: Subsidiary of Envicon Development Corp.; affiliate of Envicon Arkansas Realty Corp., Envicon Florida Realty Corp., Envilew Corp. and Envisac, Inc.

Envicon Development Corp.: Subsidiary of Southmark Corporation; parent company of Envicon Equities Corp., Envicon Arkansas Realty Corp., Envicon Florida Realty Corp., Envilew Corp. and Envisac, Inc.

Envitex Realty Corp.: Formerly a subsidiary of Envicon Development Corp., merged into Envicon Development Corp. in 1983.

Venture Development Group, Inc.: Parent company of Southern Property Management Inc., Cypress Park Development Inc., Enclave Development Corp., Maxwell Properties Inc., South Green Development Inc., U.S. Southwest Properties Inc., U.S. Properties Inc., U.S. Properties Southwest Inc., Venture Residential Inc., Venture West Corp., Venture Development Construction Inc., Venture Commercial Development Inc., Venture Community Development Inc., Venture/BT Corp., WBV Corp., South Green Associates Inc., SF Venture Corp. and VDG Land Company Inc.

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RESPONDENTS' JOINT BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents Envicon Equities Corp., Envicon Development Corp., Envitex Realty Corp., Venture Development Group, Inc., U.S. Southwest Associates, Turning Block Associates, Feit & Ahrens, William B. Bush, Jr., John W. Galston, Erving Wolf, Harry W. Burrow and Blonder, Seymour & Shapss respectfully request that this Court deny the petition for a writ of certiorari that seeks review of the decision of the United States Court of Appeals for the Second Circuit in *Salcer v. Envicon Equities Corp.*, 744 F.2d 935 (1984).

STATEMENT OF FACTS

No facts have been established in this case. The record before the United States Court of Appeals for the Second Circuit consisted of: (a) the pleadings; (b) motion papers in support of respondents' motion to compel production of documents; (c) motion papers relating to the petitioners' cross-motion to strike certain affirmative defenses; (d) the memorandum of a magistrate relating to respondents' motion for production of documents; and (e) the transcript of the oral argument regarding petitioners' cross-motion to strike certain affirmative defenses, including the district court's decision issued from the bench. Thus, any statement of "facts" at this stage of the litigation can only be a recitation of the allegations set forth in the pleadings.

Petitioners' amended complaint alleges a claim for relief under Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b), and various pendent claims under Section 33 of the Texas Securities Act, Article 27.01 of the Texas Business and Commercial Code, the Texas common law of civil conspiracy, the Texas common law of fiduciary obligations and the New York common law of negligence and professional malpractice[1] According to the amended complaint, in late 1977 and early 1978, petitioners purchased fifteen (15) limited partnership units in the Partner-

[1] In August, 1982, two of the petitioners, William Salcer and Panfeld, Edelman, et al., filed the original complaint in this case as a class action on behalf of all purchasers of limited partnerhsip units in Greenspoint Associates (the "Partnership"). After the original plaintiffs' motion for class certification was denied, an amended complaint was filed on behalf of all petitioners.

ship at a cost of $77,500 per unit. (Opinion, App. 3a)[2] The units were marketed and sold as a real estate tax shelter (Opinion, App. 3a-4a). The Partnership was formed to construct, own and operate a garden apartment complex in Harris County, Texas (the "Greenspoint Project") (*Id.*). In December, 1977, the City of Huston annexed the geographic area in which the Greenspoint Project was located (Opinion, App. 4a). Nearly four years later, in September, 1981, the Partnership sold the Greenspoint Project and petitioners received $30,000 per partnership unit (*Id.*).

Petitioners claim that respondents violated Rule 10b-5 by allegedly failing to disclose to petitioners in the private placement memorandum the proposed annexation by the City of Houston of the Greenspoint Project's location.[3] Petitioners see recissionary damages in the amount of $47,500 per partnership unit.

In addition to the $30,000 in cash that they received from the sale of the Greenspoint Project, petitioners also obtained $67,866 per unit in net tax savings through reductions in their personal income taxes as a result of the deductions generated by their ownerhsip of units in the Partnership (Opinion, App. 14a). In their answers to the amended complaint, all respondents pleaded affirmative defenses stating, in essence, that the substantial tax savings realized by petitioners as a result of their investments should reduce any damages which may be recovered (Opinion, App. 4a-5a).

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[2]References are to the Petition (Pet.) and the exhibits contained in the Appendix (App.) submitted to the Court by the petitioners.

[3]As noted above, the parties are still barely past the pleading stage in this action. Consequently, the issue of respondents' liability under Rule 10b-5 is contested and has not been tried or decided at this preliminary stage of the litigation.

In June, 1983, respondents moved the district court for an order compelling petitioners to produce documents, including petitioners' federal income tax returns for the years in which they received tax benefits from their investment in the Partnership. Petitioners thereupon cross-moved for a protective order prohibiting production of the tax returns and an order striking the affirmative defenses that alleged that the tax savings resulting from petitioners' investment in the Partnership should be offset against damages (Opinion, App. 5a).

After the conclusion of oral argument but prior to any discovery of petitioners, the district court, from the bench, orally granted petitioners' motion to strike these affirmative defenses from respondents' answers (T, App. 25a-31a). After the district court certified its order and decision as appropriate for interlocutory review under 28 U.S.C. §1292(b), respondents appealed to the United States Court of Appeals for the Second Circuit (Opinion, App. 6a).

The Second Circuit unanimously reversed, expressly holding that the district court erroneously and prematurely granted the motion to strike the affirmtive defenses (Opinion, App. 8a). The Second Circuit held that "further facts must be obtained" before the legal sufficiency of the affirmative defenses could be determined (*Id.*). The Court concluded its decision by declaring:

> "This appeal presents a classic example of the principle that a motion to strike should not be granted when there exist material issues that can only be resolved after the facts are known." (Opinion, App. 18a).

The Second Circuit also discussed generally petitioners' arguments, as well as those of the *amici curiae* – the Securities and Exchange Commission and the Tax Divi-

sion of the United States Department of Justice – concerning the scope of Section 28(a) of the Exchange Act, 15 U.S.C. §78bb(a). However, the holding of the Second Circuit was plainly limited to the propriety of granting the motion to strike the affirmative defenses.

Petitioners subsequently filed a motion for rehearing or rehearing *en banc* before the Second Circuit. The Second Circuit panel denied petitioners' motion for rehearing. In addition, no judge in active service on the United States Court of Appeals for the Second Circuit voted for rehearing *en banc* (Order, App. 24a).

REASONS FOR DENYING THE WRIT

INTRODUCTION

By reversing on procedural grounds the district court's decision to strike certain affirmative defenses and remanding the case for further proceedings, the Second Circuit followed well-settled law concerning the application of Rule 12(f) of the Federal Rules of Civil Procedure ("FRCP"). Petitioners do not argue that there is any conflict among the Circuit Courts of Appeals concerning the proper procedure under Rule 12(f).

The Second Circuit, moreover, clearly limited its discussion of the effect of the receipt of tax benefits on rescissionary damages recoverable under Rule 10b-5 to those cases involving tax shelter investments. Therefore, contrary to petitioners' contentions, the Second Circuit's discussion of this issue expressly was not applicable either to all suits for damages or to all Rule 10b-5 actions.

Finally, the decision of the Second Circuit correctly interpreted both Rule 12(f) of the FRCP and Section 28(a) of the Exchange Act.

ARGUMENT

POINT I

THE SECOND CIRCUIT'S DECISION IS NOT RIPE FOR REVIEW

As noted above, petitioners moved the district court for an order striking the affirmative defenses from respondents' answers prior to trial and prior to any discovery of petitioners in this case (Opinion, App. 7a). The Second Circuit reversed the district court's decision granting petitioners' motion and remanded the case because "further facts must be obtained before the issue can definitely be resolved in this case" (Opinion, App. 8a). The record on appeal to the Second Circuit did not even contain the private placement memorandum or the related financial projections upon which petitioners base their claim of misrepresentation under Rule 10b-5 (Opinion, App. 3a). Because petitioners only sought to strike certain affirmative defenses, neither the district court's order, appealed on an interlocutory basis, nor the Second Circuit's decision, constitute a final judgment in this action.

This Court should not exercise its discretion to grant a writ of certiorari when the factual record in the case sought to be reviewed is incomplete. Rather, in order to adjudicate only those issues which truly represent actual controversies and to refrain from improperly issuing advisory opinions, this Court's general practice has been to grant a petition for certiorari only in a case involving a final judgment. *See Brotherhood of Locomotive Firemen v. Bangor & Aroostook R.R.*, 389 U.S. 327, 88 S.Ct. 438 (1967); *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258, 36 S.Ct. 269, 271 (1916). Here, not only is the decision not a final judgment, but the Second Circuit

found that the record was inadequate to determine the merits of the district court's decision.

Thus, in light of the Second Circuit's remand of this case for further proceedings and because the factual record on appeal was found to be insufficient, the Second Circuit's decision is not ripe for review by this Court.

POINT II

THE SECOND CIRCUIT'S DECISION DOES NOT CONFLICT WITH DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS AND IS SHARPLY LIMITED IN SCOPE

The Second Circuit held that the district court erroously granted petitioners' motion to strike affirmative defenses under Rule 12(f), FRCP, prior to any discovery of petitioners in this case and in the absence of an adequate factual record. As such, this decision does not conflict with decisions of other Circuit Courts of Appeals. *See Lunsford v. United States,* 470 F.2d 221, 229-30 (8th Cir. 1977); *Augustus v. Board of Public Instruction,* 306 F.2d 862, 868 (5th Cir. 1962); *Taylor v. Orton,* 216 F.2d 62, 64 (7th Cir. 1954). The decision was both interlocutory and procedural in nature. The decision did not involve a constitutional question, nor did it finally determine the applicability of Section 28(a) of the Exchange Act to the facts involved in this case.

In their attempt to persuade this Court to review the Second Circuit's decision, petitioners misstate the holding of the Second Circuit, the rationale for that decision, and the procedural basis for the order striking the affirmative defenses. Thus, petitioners have sought to create, and then refute, a decision barely resembling the actual Second Cir-

cuit decision which is printed in full as Appendix A to the petition.

First, petitioners attempt to blur the distinction between a motion to strike affirmative defenses under Rule 12(f) and a motion for summary judgment under Rule 56. Petitioners contend that, rather than having made a motion to strike, they moved for summary judgment dismissing the affirmative defenses.[4]

It is well established, however, that a motion for summary judgment seeking dismissal of an affirmative defense is "clearly improper." *Bernstein v. Universal Pictures, Inc.*, 379 F. Supp. 933, 936 (S.D.N.Y. 1974), *rev'd on other grounds*, 517 F.2d 976 (2d Cir. 1975); *Uniroyal, Inc. v. Heller*, 65 F.R.D. 83 (S.D.N.Y. 1974); *Seacoast Liquor Distributors, Inc. v. Kips Bay Brewing Co., Inc.*, 8 F.R.D. 74 (S.D.N.Y. 1947). In any event, even if petitioners' motion to strike the affirmative defenses could be treated as a motion for partial summary judgment, such a motion should not have been determined prior to any discovery of petitioners. *See National Life Insurance Co. v. Solomon*, 529 F.2d 59, 61 (2d Cir. 1975).[5]

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[4]Petitioners ignore the fact that, even if the Second Circuit's decision could be viewed as a denial of summary judgment, this Court does not normally grant a petition for certiorari to review such a decision. *See Pacific Union Conference v. Marshall*, 434 U.S. 1305, 1306, 98 S. Ct. 2, 3 (1977) (denial of summary judgment not appealable to circuit Court of Appeals or to Supreme Court) (per Rehnquist, Circuit Judge).

[5]In those situations where the court is permitted under FRCP 12(b) and (c) to convert a motion directed to the pleadings into one for summary judgment, the Rules provide that "all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56." No such opportunity was granted to respondents and respondents have not yet obtained any discovery in this case.

Second, petitioners misrepresent the reasoning of the Second Circuit in its discussion of the effect of tax benefits on damages recoverable in federal securities actions involving tax shelters. The Second Circuit did not "conceptually divide petitioners' investment in the Partnership into two components . . . ." in reaching its decision, as petitioners contend (Pet. 4). The district court, not the Second Circuit, divided the investment into "tax benefit" and "appreciation" components. The Second Circuit discussed the district court's theory and stated that, even using such a theory, the district court erroneously granted petitioners' motion in the absence of the required factual record relating to those "components" (Opinion, App. 10a-11a).

Petitioners also attempt to distort the scope of the Second Circuit's decision and its impact on federal securities litigation in several significant ways. Most importantly, contrary to petitioners' arguments, the Second Circuit's discussion of the effect of tax benefits on the damages recoverable in Rule 10b-5 actions was not addressed to all federal securities litigation generally. Rather, the Second Circuit's discussion of this issue was expressly limited to claims for rescissionary damages under Rule 10b-5 in cases involving investments in tax shelters (Opinion, App. 8a-11a).[6]

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[6]A tax shelter investment is distinguishable from other investments within the purview of Rule 10b-5 and is one in which the "tax benefits to the partner represent an important tangible economic advantage expected to be derived from his investment regardless whether the venture eventually operates at a profit." (Opinion, App. 10a). The decision of the Second Circuit deals only with investments of this sort and does not contain any implication that the tax consequences of other types of investments are relevant to damages recoverable under Rule 10b-5, other sections of the federal securities laws or damage actions generally.

In addition, petitioners erroneously argue that the Second Circuit's decision will allow fiduciaries to escape responsibility for alleged acts of fraud by reducing the damages recoverable for those fraudulent acts (Pet. 10). In making this argument, however, petititoners completely ignore the fact that the Second Circuit's discussion of the damage issue only concerned petitioners' Rule 10b-5 claim. If any fiduciaries committed any fraudulent act in this case, then petitioners may pursue various remedies in their numerous state statutory and common law claims already asserted in this action.

The final argument regarding the impact of the Second Circuit's decision sought to be raised by petitioners is their claim that the Second Circuit's decision improperly creates a right to discovery of petitioners' federal income tax returns. In making this argument, petitioners ignore the fact that, apart from the Second Circuit's decision, respondents already have that right in this action. The district court expressly recognized that the tax status of the petitioners at the time they decided to invest in the Partnership is relevant to their Rule 10b-5 claim (Order and Transcript, App. 22a, 26a, 28a). Implicit in this ruling is the district court's recognition of respondents' right to explore petitioners' tax history and use of the tax benefits derived from their investment in the Partnership. Petitioners did not seek interlocutory review of this portion of the district court's order. Thus, review of the Second Circuit's decision would not prevent discovery of petitioners' federal income tax returns.

POINT III

THE SECOND CIRCUIT'S DECISION CORRECTLY APPLIED SECTION 28(a) OF THE EXCHANGE ACT TO THE ISSUES IN THIS CASE

Apart from the interlocutory nature of the Second Circuit's procedural decision, its limited scope, and the fact that there is no conflict among the circuits with respect to the decision's holding on the issues involved in this case, the Second Circuit's discussion concerning Section 28(a) of the Exchange Act was correct. All of the arguments raised by the petitioners are addressed and persuasively refuted in the Second Circuit's discussion of Section 28(a) (Opinion, App. 11a-18a).

Section 28(a) of the Exchange Act limits the amount of damages recoverable for violations of the Exchange Act to "actual damages." It is well-established that "actual damages" is equivalent to a plaintiff's "net economic loss," *Marbury Management Inc. v. Kohn,* 470 F. Supp. 509, 516 (S.D.N.Y. 1979), *mod. on other gnds,* 629 F.2d 705 (2d Cir.), *cert. denied sub nom. Wood Walker & Co. v. Marbury Management, Inc.,* 449 U.S. 1101 (1980), and where a plaintiff cannot show that he has suffered any actual pecuniary loss, his claim under Section 10(b) will be dismissed. *See Fershtman v. Schectman,* 450 F.2d 1357, 1361 (2d Cir. 1971), *cert. denied,* 405 U.S. 1066 (1972); *Levine v. Seilon, Inc.,* 439 F.2d 328, 335 (2d Cir. 1971).

The purpose of an award of damages in actions for fraud or deceit is "to place the plaintiff in the position he would have been in if the injury had not occurred." *Harris v. Standard Accident and Ins. Co.,* 297 F.2d 627, 631-32 (2d Cir. 1961), *cert. denied,* 369 U.S. 843 (1962); *Glidden Company v. Hellenic Lines, Ltd.,* 207 F. Supp. 262 (S.D. N.Y. 1962) (award of damages designed to reimburse, not

to enrich), *aff'd,* 315 F.2d 162 (2d Cir. 1963); C. McCormick, *Damages* §121, 449 (1935); Restatement, Second, *Torts* §901 (1979).

Accordingly, a failure to deduct all benefits received by a plaintiff would award the plaintiff a windfall which would be equivalent of an award of punitive damages. Section 28(a) prohibits any award of punitive damages. *Osofsky v. Zipf,* 645 F.2d 107 (2d Cir. 1981); *Byrnes v. Faulkner, Dawkins & Sullivan,* 550 F.2d 1303, 1313 (2d Cir. 1977); *Green v. Wolf Corp.,* 406 F.2d 291, 293 (2d Cir. 1968), *cert. denied,* 395 U.S. 977 (1969).

In this case, the Second Circuit relied on these established principles of law to indicate that, in the context of a tax shelter investment, rescissionary damages sought by a plaintiff in a Rule 10b-5 action may be reduced by the value of the permanent tax saving he received from the investment (Opinion, App. 9a-11a).

The only decision by a Circuit Court of Appeals which held that tax benefits should not be deducted from a damage award involved a case in which the plaintiffs had been awarded actual rescission of their investment. *Burgess v. Premier Corp.,* 727 F.2d 826 (9th Cir. 1984). *Burgess* is, therefore, distinguishable from this case, as the Second Circuit noted at App. 17a. The other Court of Appeals decision on this issue, *Austin v. Loftsgaarden,* 675 F.2d 168 (8th Cir. 1982) *rehearing en banc granted* (October 17, 1984) is consistent with the Second Circuit's discussion of Section 28(a). Thus, there is no conflict among the Circuit Courts of Appeals regarding the treatment of tax benefits in cases involving the possible recovery of rescissionary damages in a Rule 10b-5 action.

Petitioners' arguments concerning the impact of the Second Circuit's decision on the eagerness of investors to file

federal securities claims and the possible differences in damage awards for plaintiffs in different tax brackets ignore the compensatory purposes of Section 28(a). As the Second Circuit stated:

> "The standard established by §28(a) for determining the amount of damages to be awarded is not the egregiousness of the defendants' conduct but the extent of plaintiffs' actual injury. To ignore the sizeable tax benefits actually realized by the plaintiffs would be unrealistic. There is nothing improper or unusual in taking tax considerations into account in determining the amount of damages to be awarded. *See Norfolk & Western Railway Co. v. Liepelt,* 444 U.S. 490, 100 S.Ct. 755, 62 L.Ed.2d 689 (1980); *O'Connor v. United States,* 269 F.2d 578 (2d Cir. 1959)." (Opinion, App. 12a).

CONCLUSION

For the reasons stated, this Court should deny the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

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